



Workshop on Analysis of Trends in the Salvadoran Microfinance Industry

Final Report

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Objective

On October 2, 2002 FOMIR facilitated a workshop for partner financial institutions that serve the Salvadoran microenterprise market in order to identify and prioritize trends likely to impact the microfinance industry within the next three to five years.¹ The workshop was a preliminary step towards determining whether there is cause for competing institutions to work together on specific industry-level issues they are likely to face in the future. The goal of this document is to summarize the workshop, identify common and interrelated themes, and suggest potential collective initiatives for further discussion.

Methodology

In order to identify important issues, participants went through an environmental scanning exercise designed to look at trends in five broad categories: Social, Technological, Economic, Environmental, and Political (STEEP analysis). Participants brainstormed the trends in each category, and then presented those most likely to affect the microfinance industry in the coming years. The current and future trends identified in each category were:

Social

- Increasing necessity for more and improved training of staff and management
- Headhunting of qualified staff by financial institutions serving microenterprises
- Increasing need for more highly qualified staff as institutions become more complex
- A generally greater need to invest more in Human Resources
- The emergence of a labor market for microfinance
- Increasing mobility of clientele and Rural-Urban migration complicate service provision

Technological

- Rising cost of Information and Communications Technology makes it increasingly important for institutions and their staff to use IT efficiently
- Rising minimum level of IT required for institutional growth and formalization
- Increasing communication requirements for online branch networks
- Increased importance of improving credit bureaus and information standards

Economic

- Reduction in the cost of funds likely to benefit the microfinance industry
- Microenterprises gain increasing access to a variety of financial products
- Microenterprises increasingly seen as an option for the rising number of unemployed
- Reduction in family remittances (some disagreement here, reduction not expected during next five years but anticipated subsequently)

¹ Participants included: Santiago Sánchez, General Manager, ACCOVI; Sandra Samayoa, ACCOVI; Wilson Salmerón, General Manager, AMC; Luis Castillo, Executive Director, FUSAI/Integral; Manuel Torres, Consultant, Accion / INTEGRAL; Ricardo Segovia, Executive Director, ASEI; Sandra de Martínez, ACACU; Patricia Ramírez, CALPIÁ; Silke Muffelman, General Manager, CALPIÁ; Martín Moreno, ACACSEMERSA; Abel Aguirre, ACACSEMERSA; Edgardo Velásquez, Microcredit Coordinator, BANCO SALVADOREÑO; Sandra Lorena Duarte, Economic Growth CTO, USAID/El Salvador; and Doug McLean, FOMIR/DAI Chief of Party. Nathanael Bourns and Robin Young of Development Alternatives, Inc., facilitated the workshop.

- Global economic slowdown affecting the Salvadoran economy

Environmental (microfinance business environment)

- Primary microfinance markets facing likelihood of saturation over the medium term
- Increasing competition among microfinance service providers
- Increasing diversity of sources of funding and capital for microfinance
- Increasing substitutes for microfinance products
- Growth in number of microenterprises creating greater demand for credit
- Clients becoming more discerning and more free to choose among institutions

Political

- Greater pressure toward tax collection and formalization among microenterprises
- Shifting USAID focus toward non-financial and business development services leaves fewer resources for microfinance, and remaining programs emphasize institutional self sufficiency (not all participants agreed that this is the trend among most donors)
- Superintendency of the Financial System continues to have limited capacity to regulate microfinance properly
- Superintendency's current interpretation of the banking secrecy law creates barriers to the exchange of information between regulated and non-regulated institutions
- Salvadoran Government continuing to support state banks in microfinance
- Government of El Salvador continuing to dedicate few resources to generating data that could be useful for microenterprise market intelligence
- GOES interest in microfinance continuing to focus on regulated institutions

After identifying key trends in each category, participants ranked each one based on their estimate of both the degree of certainty that the particular trend or event would occur, or continue, and the degree of impact that each could have on the microfinance industry.

Participants ranked the majority of the trends in the range of high to medium impact and high likelihood of occurring. Some of the more important themes that cut across a number of the trends that emerged from the exercise and subsequent discussions involved competition and information sharing, human resources, regulation, technology, and funding sources.

Preliminary Areas for Common Action

Individual financial institutions regularly deal with aspects of each of these themes, and certainly many of the related issues are most effectively handled individually within each institution. Other issues would ideally be handled collectively, some of which may currently be done through existing associations. However, issues specific to microfinance may not be a priority for all members of some existing associations (e.g. FEDECACES, ABANSA). For some issues, where there are converging interests among a diverse set of institutions, it appears to make sense for institutions to organize themselves not just around institutional typology, but also around common interests. The following sections tie together some of the trends identified and offer a brief analysis and preliminary suggestions for working together on areas of common interest.

Competition for Clients

Participants expressed broad agreement that they are facing increased competition in what may be a smaller market than some of the existing market data suggest. Still, while a trend towards market saturation was prominent in group discussions, participants clarified that saturation in the near to medium term is probably limited to credit services in the primary and secondary urban markets. This suggests that there may still be significant demand not only for new credit, savings and other financial and fee-based products in presently well-served markets, but also for a full array of services in some rural areas. It is important to note that while credit may be the primary type of financial service to which microenterprise clients have access, participants indicated that their clients are gaining greater access to microcredit substitutes, such as store credit, offers to purchase goods in installments, and other forms of consumer credit.

Greater competition among institutions for microenterprise clients and clients' improved access to both microfinance products and to substitutes make it important for institutions to have more complete credit information at their disposal. However, a series of conditions currently limits the utility of available credit information services for microfinance: 1) technological constraints within institutions involving the lack of standardized data collection and reporting systems; 2) regulatory barriers that currently prohibit banks and other regulated financial intermediaries from sharing client information with non-regulated financial institutions; 3) many of the providers of substitutes and others who serve the microenterprise market either do not report to credit bureaus or have limited capacity to supply complete and accurate information; and 4) the lack of consistent use of a national unique identification document to facilitate accurate client identification.

Participants indicated that clients are becoming more savvy users of credit, demanding better terms and demonstrating they are not tied to a particular institution. Competition among service providers is generally good for the client, as long as it does not lead to over-indebtedness, which harms clients and institutions alike. Theoretically, a competitive environment is more conducive to innovation and places a premium on, among other things, efficiency and market intelligence. But if the government continues to commit limited resources to the area of market research, as was identified, individual institutions may have to devote more time and resources to market intelligence.

It is also worth noting that participants believe the microenterprise market will continue to provide an alternative to unemployment, which could increase in the coming years, leading to a larger pool of microenterprises that require financial services. But the identified tendency toward a bigger microfinance market with pockets of higher saturation implies the supply of services will have to grow significantly as well. Such a scenario suggests that those institutions able to access financing at lower costs and invest most effectively in human resources, systems and infrastructure to prepare for rapid growth are those that will thrive and likely gain market share.

Clearly, institutions must make internal preparations and decisions for how best to deal with competition. However, some of these issues suggest that the following collective action could be considered:

- Determine a level of market research, or specific research agenda, for which it makes sense to pool resources to obtain general market data that can then be tailored and augmented for institutions' individual business planning and marketing needs.
- Form a coalition to work on a comprehensive legal framework for credit reporting, such as the US Fair Credit Reporting Act, tailored to the Salvadoran market and legal framework, taking into account needs for new legislation, interpretation of existing legislation and consumer protection issues. Consider working through, or with, existing associations, such as ABANSA, and other interested parties.
- Work with credit bureaus and the Superintendency to build consensus on the document (or combination of documents) financial institutions should use to identify clients, and report to credit bureaus in order to facilitate credit information sharing. Identify the potential benefits to the financial services industry (e.g. improve accuracy and confidence in credit information) and to clients (e.g. improve speed of service). If necessary, work with clients to and the GOES to facilitate the process of obtaining relevant identification documents.
- Develop dialogue with policy makers, public officials and business leaders knowledgeable and responsible for economic and social issues to broaden understanding about relevant issues that affect the sector

Human Resources

Participants expressed concern over the industry's current status and developing trends in the area of Human Resources. The most obvious concern appeared to be directed towards headhunting at the loan officer to lower and middle management levels. For such individuals with training and experience in microfinance, a market appears to be developing in El Salvador, but it is likely a market with short supply of qualified individuals. Also, participants noted that growing institutions become more complex and tend to require a greater level of sophistication among their human resources, especially among management and technical specialists, such as qualified information technology professionals, which are difficult to find and generally expensive.

All of these factors imply that, as identified, a greater investment in human resources will be necessary in the future. There is probably a rationale for part of this greater investment to be made collectively in order to further understand the current microfinance labor market and to develop alternative ways of dealing with it. If there is truly a labor market developing for individuals with microfinance skills in El Salvador, agreements among financial institutions to refrain from headhunting are unlikely to overcome market forces. It is necessary to consider ways in which microfinance institutions and/or other industry actors can contribute to expanding the pool of qualified individuals while also making themselves more attractive to potential new hires. Areas for potential collective action that may merit further discussion include:

- Research the job market for qualified individuals to determine the true supply and demand for various types of staff. Determine whether there are other industries with similar human resource needs, such as the need for IT specialists among non-financial

companies, to see if there are common interests and possibly a justification for public funding.

- Market microfinance careers at job fairs
- Create an industry approved practical curriculum for technical education and training in diverse areas of microfinance (finance, credit, information technology, etc.) in collaboration with technical schools, training institutes and/or universities that responds directly to current and future human resource requirements. The industry could certify instructors and continuously influence the curriculum. If there is interest in an intervention involving public funds, consider vouchers as a way to stimulate the technical training market.

Regulation

The most highly ranked trends in terms of importance regarding regulation involved the capacity of the Superintendency of the Financial System to regulate and supervise microfinance appropriately. Related to that point, the Superintendency's current interpretation of the banking secrecy law creates barriers to information sharing between regulated and non-regulated financial institutions. Regulation is one area where there is a clear rationale for acting collectively, since part of the work that is necessary requires persuading regulators to change, or in some cases, lobbying for a modification to existing legislation. Advocacy is generally most effective where a broad coalition can be formed.

In addition to collective action on regulation related to credit information sharing mentioned previously, suggested areas for action could include:

- Determine as an Industry the specific set of laws, regulations and supervisory practices that restrict prudent microfinance and advocate jointly for change by proposing specific modifications to existing legislation or new laws
- Find avenues to educate regulators on microfinance by exposing them to successful international models
- Work together to better understand the Superintendency's concerns and priorities and attempt to improve regulators' understanding of the microfinance market and specific approaches to supervision by offering training or seminars on how to evaluate risk within a microfinance institution or portfolio.

Technology

Participants claimed that for scaling up operations, it has become increasingly necessary to make large investments in information and communication technologies. These investments include not only the hardware and software, but also communications systems and infrastructure, the human resources to administer and use the required systems, ongoing maintenance and upgrade costs and consultations with the vendor, etc. This is recognized as a part of doing business for institutions that want to grow in a sustainable manner.

According to some participants it also is becoming more important to have branches online in order to comply with regulations, to manage a branch network more effectively, and to cater to a

more demanding and highly mobile client base. Technology also will play an important role in the improvement of credit bureau information and in the standardization of reporting, as mentioned earlier.

Given the need to invest significantly more in IT as institutions grow, ways to for institutions to consider working together could include:

- Form buyers' groups to negotiate with software vendors and service providers to reduce the cost of the information technology where appropriate.
- Examine options for shared communication lines in areas where communications costs restrict operations.
- Consider other types of alliances (such as shared technical staff, strategic partnerships, mergers) as ways to increase operations and income that IT systems support, hence spreading out the costs.

Funding Sources

Participants agreed they have seen higher volume and greater diversity in the potential funding sources available to them, as well as lower interest rates (for those accessing commercial funds), which participants viewed would lower their cost for commercial sources of funding. This has coincided with what most see as shifts in donor funding approaches away from concessionary financing toward a more commercial orientation (e.g. through loans), or a focus on funding technical assistance rather than capital for loan portfolios and operations. Participants were not in agreement that overall donor funding in the sector is being reduced but did agree that new actors are appearing and in general a shift has occurred. Sandra Lorena Duarte of USAID reinforced that there has been a shift commenting that USAID El Salvador's assistance to the microenterprise sector is moving toward business development services and enhancing national competitiveness, and that USAID assistance to microfinance institutions will be more focused on the most efficient and capable institutions.

Dealing with changes in funding sources is an area that individual institutions must face on their own, but a couple of potential areas for collective action in the area of funding sources could include:

- Conduct a collective study to identify all of the potential sources of donor, government and commercial funding and outline requirements and future plans for financing the sector.
- Work together to make a clear presentation to donors and other potential funding sources regarding the types of assistance that are required, in order to increase the likelihood that assistance will be responsive to identified needs.
- Improve standardization and dissemination of institutional information (e.g. financial statements and other key financial and operational information) for interested investors, donors, etc.

Next Steps

The next step in this activity will be to disseminate this preliminary report to participants and, assuming there is continued interest among the original participants, hold a follow-up meeting with the same group to discuss the report and potential areas for collective action. Participants should determine whether this report is an accurate reflection of the most important trends that emerged from the first workshop, consider the potential options for collaboration presented, and propose any other relevant options not addressed here. The collective actions suggested here are presented for consideration, but should not limit participants' thinking in terms of possible collaboration. It is important to note that some participants may not find it in their best interest to commit time and resources to all of the issues that the rest of the group identifies, and it is unnecessary to do so where there are diverging interests.

Based on the prioritized trends the follow-up workshop will examine potential options for collective action, and prioritize those that: 1) are responses to high impact / high probability trends, 2) can feasibly be conducted collectively, and 3) can reasonably be expected to have a significant impact. In other words, participants should identify potential collective actions that could define the future direction of important aspects of the microfinance industry.

For each issue that is prioritized for collaboration, assuming that there is one or more, interested parties should clearly establish the following:

- **Vision** – a statement of what collective action will attain.
- **Goal** - the end or desired result toward which joint efforts are directed, a statement of what the group must achieve to attain its vision.
- **Strategy** – the approach that the group will employ to attain the identified goal
- **Stakeholders** – the individuals, groups, organizations, associations, government bodies, donors, and projects who can affect, or be affected by, the desired outcome of this issue; and their interests in the issue.
- **Objectives** – specific, measurable activities that will help accomplish the goal.

These factors can form the basis for an **action plan**, in which interested parties establish detailed activities, a timeline, specific deliverables, implementation methodology (including an approach to coalition-building, where appropriate), partners, stakeholders, and required resources. The next step would be to establish a realistic **budget** and a **progress monitoring plan**. For each area of collaboration interested parties should ensure that:

1. There is a results-focused basis from which to work together
2. Assumptions and plans are based on quality information
3. There is clear (written) understanding among the parties
4. Plans are flexible and realistic
5. Issue leaders are established with defined goals for others involved
6. Results are measurable